STATE OF CALIFORNIA
CONSUMER POWER AND CONSERVATION
FINANCING AUTHORITY

Rulemaking:
Establishment of Target Reserve Level for the California Power Authority Investment Plan

Docket 2002-07-01

COMMENTS OF SEMPRA ENERGY ON DRAFT DECISION

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I.

INTRODUCTION

Pursuant to the schedule established by the California Power and Conservation Financing Authority (CPA), Sempra Energy (Sempra) hereby files the following comments on the above-referenced Draft Decision (Draft). In this proceeding, the CPA intends to set a target reserve level for purposes of developing its annual Electric Resource Investment Plan in February 2003 (Draft, p. 1). The proposed reserve level in the Draft is 22%, with 25% to 50% of that reserve level to come from demand reduction programs (Id.). Sempra appreciates the opportunity to share its views with CPA on this important undertaking. Accordingly, Sempra discusses below certain overarching principles that should guide the CPA's general approach to this issue, as well as specific proposed modifications to the Draft.

As indicated in earlier comments filed on this rulemaking, a number of agencies are considering the target reserve level issue. These agencies include the Federal Energy Regulatory Commission (FERC), the California Public Utilities Commission (CPUC),

the California Independent System Operator (ISO), and the California Energy Commission (CEC). The CPA has a unique perspective and mission, and Sempra therefore continues to encourage the CPA to work with those other entities to provide guidance and assistance in the determination of reliability requirements. The CPA could be particularly effective working with regional authorities to assist in developing regional assessments of an optimal reserve level and resource adequacy.[1/] While the Draft certainly provides important insights to be considered in assessing a target reserve level, the recommended figures are not based on a rigorous analytic foundation. As such, they should be regarded as exemplary only.

The Draft also recommends that 25-50% of any capacity requirement be met through demand reduction efforts. Certainly a promising opportunity for Californians to protect themselves from market volatility is enhancing their ability to manage energy use. The requisite metering, deployment, and implementation issues associated with demand responsive rates and programs provide CPA with a chance to make a valuable contribution to this important area, such as by financing demand reduction programs. The CPA is in fact one of the agencies, along with the CEC, coordinating the CPUC rulemaking on advanced metering and dynamic pricing options and programs (R.02-06-001).

1/ In addition, Sempra notes that under recently passed SB 1389, the CEC will be submitting an Integrated Energy Policy Report to the Legislature and the Governor on November 1, 2003. This effort has already commenced (see CEC hearing notice dated October 9, 2002, and staff proposal for consideration at October 22, 2002 hearing). The CPA should focus in particular on contributing to analysis for the Report on (1) the appropriate manner in which reliability should be addressed in the development of primary energy infrastructures, and (2) the extent to which demand response and conservation should be developed to reduce risks to consumers. In fact, the Legislature directs that state agencies, including the CPA, carry out their duties consistent with the Report (Pub. Res. C. § 25302(f)).

Sempra also shares CPA's concern over market stability as a consumer protection issue. Adequate generation and transmission are essential for California, yet at the same time, it is critical that California's electric consumers not be saddled with paying for excess capacity that could result in part from a high level of reserves. CPA as a financing authority has a special role that needs further definition. Sempra believes strongly, though, that CPA should not build or own power plants. Within that framework, however, there are fruitful options to explore, particularly given the current financial situation of California's investor owned utilities. CPA might provide, for example, a valuable financing source for urgent infrastructure needs.

Consistent with these guiding principles, Sempra recommends specific modifications to the Draft, as discussed in further detail below.

II.

DISCUSSION

A. CPA's Role and Coordination With Other Proceedings

The CPA acknowledges that a number of other proceedings are occurring parallel with its own efforts, including the ISO's proposed market design changes, the FERC's Standard Market Design Notice of Proposed Rulemaking (SMD NOPR), and the CPUC's electricity procurement rulemaking (R.01-10-024). The CPA explains that each of these proceedings approaches the concept of the capacity adequacy requirement from a different perspective, and that none accurately reflects the mission of the CPA, "which is to assure that the state of California has adequate reserves to promote reliability and ensure stable electricity pricing" (Draft, p. 4). As such, the CPA views the output from this Draft to "be a base element of guidance in other regulatory proceedings and in

decision making processes about capacity at all levels, including FERC, state and municipal boards, and city councils" (Id. at 4-5).

The CPA correctly observes that any target reserve level adopted in this proceeding should be regarded as advisory only, for precisely the reasons that the Draft explains. For example, the Draft acknowledges there are many reasons why individual utilities may differ from the targets suggested in the instant rulemaking, including the type of resource, different operating characteristics or capabilities of various technologies, contract terms and conditions, and level of risk tolerance (Draft, p. 25). The CPA recognizes that the affected Load Serving Entities (LSE) will ultimately be addressing these issues more specifically with their respective regulators (Draft, p. 3).

The conclusions from this rulemaking should therefore inform the functions of the CPA's own investment activities, as well as provide factual input that is available to other proceedings. The CPA should remove from its Draft, however, any statements or implications that a reserve level adopted in this proceeding is a regulatory directive or "starting point from which deviations might be made" (see, e.g., Draft, p. 25).

The CPA might also consider a different approach altogether to addressing this issue. For example, rather than adopt a target reserve number, the CPA could apply its funding and financing authority towards advancing demand reduction programs where appropriate. The CPA could also become, as the Draft states, the "champion" of renewables and offer attractive financing or otherwise develop opportunities for these resources (p. 17). This approach would integrate more easily with the work of other agencies and avoid the need to reconcile inconsistent results and divergent numbers among the various entities addressing target reserve levels.

B. Proposed Target Reserve Level

The Draft proposes a target reserve level of 22%, with 25% to 50% of that amount to come from demand reduction programs. The Draft continues with a discussion of various underlying elements that were important to the CPA's development of those figures.

Sempra observes as a general matter that reserve margins are a crude measure of reliability or a way to establish the minimum level of supply reliability that electric consumers should receive. For example, two LSEs might each have installed reserve margin targets of 22%, but if one LSE's resource mix includes significant amounts of wind and the other LSE has all combined-cycle combustion turbines, the two LSEs are not contributing equally to the grid's supply reliability requirement.[2/]

Instead, an objective measure of the relationship between different levels of supply reliability, and a consumer's willingness to pay for those levels, needs to first be established. Until this level is known, it is not possible to determine whether any LSE's resource portfolio will supply the minimum level of reliability that consumers want. Therefore, while the CPA states that typical loss of load studies have produced installed reserve requirements from 18% to 20%, that range may or may not be applicable to a given mix of resources, and the Draft is silent regarding the minimum loss of load level that consumers might be willing to accept. Consideration of the optimal level of reserves should therefore balance the desire of consumers for reliable service with their interest in

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2/ Sempra also disagrees with the unsupported proposition in the Draft that "if there is to be a competitive market, and no exercise of market power, it seems self-evident that reserve levels must be greater in a market paradigm than when one company owned all of its needs and there was no concern about competition" (Draft, p. 14). The Draft offers no analytic basis for that statement, and the higher capacity factors of generation units since divestiture would seem to contradict the CPA's assumption.

reasonable costs. A "general target" of a particular level of reserves that does not have any valid cost or reliability basis is of little value.

The Draft's position that it is necessary to know in advance where the power will come from to meet an LSE's load is not well-grounded (Draft, p. 20). Standard capacity and energy products have proven extraordinarily reliable with a high rate of deliverability. In fact, the ability of a supplier to consistently perform under these standard contracts is mainly due to the supplier's ability to draw from a portfolio of resources rather than from a specific generator, and reliance upon a specific generator may provide less reliability due to the forced outage risk. Consumers are therefore better served if the identification of a specific generator is left to the discretion of the buyer and the seller, to the extent appropriate. The Draft should eliminate the discussion regarding this issue from the final rulemaking, or revise it as set forth herein.

The Draft also addresses the question of how to value "uncontracted" capacity that is installed but not under contract to any particular entity, and is presumably only available in spot markets (Draft, p. 21). The Draft concludes that with a reporting requirement in place to the California ISO, uncontracted capacity should "be counted at 50% to reflect the uncertainty that it will be available in any particular time frame" (Draft, p. 22). There will be no need to assign a discount or value to uncontracted capacity in the instant proceeding. In a market design where the ISO makes the determination, on a forecast basis, as to the amount of capacity under contract to the LSE, or sold to the ISO through an annual auction, uncontracted capacity does not qualify as meeting any part of an LSE's supply obligation. This process is currently under

discussion in the ISO market re-design proceeding and in FERC's SMD NOPR. Therefore, there is no need for the CPA to address this issue in the instant rulemaking.

The Draft also asserts that capacity ratings for merchant plants should be considered below the capacity factors for utility plants. Sempra's experience, however, is that capacity factors for previously utility-owned plants have actually increased after divestiture. Sempra also questions the Draft's differing treatment of hydro capacity factors relative to fossil fuel plants. It is unclear why fossil plants would be more heavily discounted when hydro facilities have the greatest variance in deliverability.

C. Demand Reduction Programs

The Draft determines that 25% to 50% of the adopted reserve level should be met through demand reduction programs (Draft, pp. 17-19). Sempra supports an evaluation of the important role that these programs can have on reducing consumption. Recognizing that the recommended target figures in the Draft have not been reached based on rigorous analysis, the proposal is a useful starting point for discussion. The Draft correctly notes, however, that a comprehensive rulemaking to develop advanced metering and dynamic pricing programs is underway before the CPUC, the CEC, and the CPA. Therefore, any specific reduction targets attributable to demand response should only be adopted, if at all, after that proceeding has concluded.

To the extent demand reduction targets are addressed here, however, cost considerations are essential to the analysis, especially in terms of commensurate benefits. Otherwise, price signals are distorted and inefficient consumption and investment decisions may result, thereby defeating the purpose of the role that demand reduction

should have in the market. The Draft does not currently address the important aspect of assessing the costs to achieve the proposed demand reduction targets.

III.

CONCLUSION

Sempra would emphasize that CPA's coordination with and participation in other proceedings should be the primary emphasis of the agency at this time with regard to addressing a minimum level of supply-related reliability. As part of this effort, the CPA could undertake an assessment of whether funding support for demand reduction programs or renewable resources is required. To the extent a specific target reserve level is proposed in the instant proceeding, however, it is essential that it be regarded as strictly advisory and exemplary to other agencies.

Dated this 11th day of October, 2002, at Los Angeles, California.

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